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TAGS: [ENRG](#) [EPET](#) [KZ](#)

SUBJECT: KAZAKHSTAN: AMBASSADOR BRIEFS OIL EXECUTIVES ON
SECRETARY BODMAN'S VISIT

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REF: A. ALMATY 960
[1](#)B. ALMATY 1085
[1](#)C. ALMATY 886
[1](#)D. BAKU 368

Classified By: Ambassador John Ordway for reasons 1.4(B) and (D).

[1](#)1. (C) Summary: Ambassador briefed ExxonMobil (EM), Chevron, and ConocoPhillips (CP) representatives on Secretary Bodman's visit to Kazakhstan (Ref A) in separate March 16-17 meetings. In follow-on conversation, EM and CP representatives confirmed Shell's earlier report (Ref B) that a recently-discovered design flaw would significantly delay first Kashagan production. The EM executive reported recent progress in resolving the Caspian Pipeline Consortium (CPC) standoff on management secondees and internal control procedures. However, he painted a bleak overall picture of the CPC talks: the issue of expansion aside, Russian brinkmanship was endangering the shipment of base volumes; Russian negotiators seemingly had no political will to conclude the negotiations; and, consistent with Chevron's view (Ref C), key Russian actors appeared to have personal financial interests in linking expansion to the construction of a Burgas-Alexandroupolis (B-A) bypass pipeline. CP's representative confirmed Baku reporting (Ref D) that the Azeris appeared poised to renegotiate fundamental parts of the initialed Baku-Tbilisi-Ceyhan Inter-Governmental Agreement (BTC-IGA).

[1](#)2. (C) Summary (continued): The EM and CP executives reacted favorably to the idea of an Aktau-Baku Trans-Caspian gas pipeline, while echoing widespread industry skepticism about the GOK's push to develop a domestic petroleum industry. EM voiced no interest in being a "first-mover" in building a Bosphorus bypass, telling Ambassador that a bypass was not economically feasible without Russian participation. Finally, reflecting on Energy Minister Izumkambetov's surprise appeal to Secretary Bodman to intervene in the Tengiz "royalty-in-kind" issue (Refs A,C), Chevron's representative declined the Ambassador's offer of help, for the time being, explaining that Chevron was still optimistic that it could resolve the problem on its own. End Summary.

Ambassador Briefs on Secretary Bodman's Visit

13. (SBU) Ambassador briefed EM's General Manager, David Willis, and Government Relations Director Yelda Guven; CP's Country Manager Hakim Janah; and Chevron's Deputy Eurasia Manager Ted Etchison in separate March 16-17 meetings, following Secretary Bodman's March 13-15 visit to Kazakhstan.

CPC Negotiations

14. (C) EM's Willis informed Ambassador of recent progress in the CPC expansion negotiations: shareholders had unanimously approved a Russian proposal to allocate management secondees (excepting the General Director and Deputy General Director) in proportion to equity; the shareholders had also approved a package of internal management and audit procedures. However, Willis continued, the bigger picture remained bleak. The Russians, he said, "appear to have no political will to conclude the negotiations." Even President Nazarbayev seemed to have resorted to a long-term view, recently telling EM's Chairperson that completion of the final 700 km leg of the Chinese oil pipeline (expected to take at least two years) might pressure the Russians to conclude the CPC negotiations.

15. (C) Willis echoed Chevron's suspicions that key Russian actors, especially TransNeft's Seymon Vaynshtok, had personal financial reasons to link CPC expansion to the construction of a B-A bypass. Willis suggested that, if American companies were involved in operating a B-A bypass, Russian opportunities to make illicit gains would be limited. Where Vaynshtok and others really hoped to cash in, he said, was on Black Sea shipping. (Comment: Willis's analysis does not explain why the Russians are pushing specifically for a B-A bypass. Guven offered a geopolitical reason, suggesting that

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the Russians wanted to limit Turkey's influence as a transportation corridor. End comment.)

16. (C) The issue of CPC expansion aside, Willis said, Russia was beginning to obstruct ordinary pipeline operations in a presumed act of brinksmanship. Russia had blocked the approval of an annual budget, forcing the company to work quarter-by-quarter. Russia was also blocking a proposal to replace the heavily-corroded Tengiz-Atyrau segment of the pipeline; the pipe was in such poor shape that it was almost impossible to repair. Finally, the Russians were blocking necessary amendments to the CPC-Kazakhstan charter; luckily, the GOK had adopted legislation which mitigated most of the legal consequences of the delay. All of these issues would be raised again in CPC meetings in Oman during the week of March 20, Willis said, but prospects for settlement seemed dim.

BTC: Azeris to Reopen Negotiations?

17. (C) CP's Hakim Janah echoed Embassy Baku's recent reports that the BTC-IGA negotiations were also troubled. The Azeris, he said, had recently issued a "re-draft" of the IGA which limited investor protections. Furthermore, the Azeris appeared intent on negotiating the IGA and the HGAs simultaneously. Janah voiced concern that the new Azeri approach would, in turn, jeopardize concessions already made on the GOK side on the important issues of ratification and tax stability.

Kashagan Delays

18. (C) Both Willis and Janah confirmed Shell's report (Ref B) that a major design flaw in Kashagan's offshore facilities would significantly delay first production. Kashagan, Willis said, was "a project in crisis," and operator AGIP

"incapable." Willis explained that project partners had identified the design flaw -- which posed the threat of poisonous gas leaks -- "a year ago." AGIP had subsequently reported that it had rectified the problem, only to have a recent review make clear that a complete redesign was required. In response, Willis said, consortium partners would intensify efforts to reduce AGIP's effective control of the project. "Their name will stay on the shingle," he said, but large parts of the project would be outsourced to other partners, who would also nominate growing numbers of management secondees.

¶9. (C) Asked by Ambassador whether the GOK was aware of the design flaw, Willis noted that AGIP had briefed KazMunaiGaz's Managing Director for Transportation, Kaigeldy Kabyldin. It wasn't clear, however, if the message had reached top GOK levels: "no one wants to be the messenger." CP's Janah explained that AGIP's CEO had recently held a press conference in which he had repeated "information that he knows is false" regarding project completion dates and cost. Janah expressed concern that AGIP's lack of candor would create bad will with the GOK. Willis acknowledged that the consortium partners were vulnerable to charges of "breach of contract," and predicted that the issue would "tie up our lawyers for years to come."

Gas Issues: Trans-Caspian Pipeline and Petrochemicals

¶10. (C) Willis told Ambassador that, in his view, a Kazakhstan-Azerbaijan Trans-Caspian gas pipeline "made economic sense." However, he asked, what about delimitation issues? Ambassador suggested that it might be possible to design a route which, under any set of territorial claims, would traverse only Kazakhstani and Azerbaijani territory. Guven voiced doubt: in her interpretation, the 1998 Kazakhstani-Russian bilateral delimitation agreement gave Russia the right to block any transnational Caspian project Kazakhstan participated in, even if Russia's Caspian territory was not affected.

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¶11. (C) Willis underscored the importance of securing Turkmen gas for the pipeline, because "Kazakhstan has no gas to sell right now." Willis suggested that the government might be banking on unrealistic volumes of Kashagan and Tengiz gas, the vast majority of which would be reinjected. Twenty years down the road, he said, things would be different. (Note: CP's Janah suggested that the "N" Block would be an excellent future source of gas for a Trans-Caspian pipeline. The field had proven gas, he said, perhaps on the order of 5-10 tcf; early Soviet drilling had discovered gas at a depth of 500 meters. End note.) Reflecting on the GOK's ambitions to build a domestic petrochemical industry, Willis explained that EM had taken an "updated look" at industry prospects in 2005, and concluded that the industry was not viable. Even if feedstock prices were pressed to "nothing," Willis said, the price of building necessary infrastructure would result in petrochemical production prices "double" those of the Saudis. Until the GOK invests in a lot of support infrastructure, he concluded, the industry will remain economically unfeasible.

¶12. (C) Note: Energy Minister Izmukhambetov recently told Ambassador that the GOK was "intrigued" by the idea of a Trans-Caspian gas pipeline. The Russians had thus far been unwilling to complete a deal to expand the Orenburg gas processing plant as a Kazakhstani-Russian joint venture, leaving open the possibility that Karachaganak gas would be free for other uses. End note.

ExxonMobil: Not a Bosphorus Bypass "First Mover"

¶13. (C) Willis told Ambassador that, based on an EM study

made a year ago, a Bosphorus bypass "didn't appear economic."

Ambassador countered by suggesting that a bypass should be seen as insurance against a possible disruption of Bosphorus traffic, and that insurance policies were not, by their nature, "economic." Willis pointed out that CPC expansion would only add "one tanker a day" to Bosphorus traffic. He admitted only that the EM study had not accounted for possible discounts placed on Tengiz crude by buyers worried about the unreliability of winter shipments through the Bosphorus. "We'll take another look," he said. He then appeared to arrive at his real objection: to get Western participation in a bypass, he said, "we need a Russian commitment to put their oil through." Otherwise, he concluded, "we'll pay for a pipeline while they sail their dangerous ships through the Bosphorus, waving at us."

Tengiz Royalty-In-Kind Oil

¶14. (C) After briefing Etchison on Izmukhambetov's appeal to Secretary Bodman to lobby Chevron to dispose of Tengiz sulfur

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and agree to deliver the GOK's Tengiz royalty oil "in kind," Ambassador proposed one way in which the USG might help secure the GOK's pledge not to ship the royalty oil onward to Iran. The Embassy, he suggested, could ask that the GOK make the pledge in the form of a diplomatic note. Etchison thanked the Ambassador for the offer, and said he would consult on the issue with top management. In general, however, Chevron was still optimistic that it could resolve the issue on its own. (Note: Willis told Ambassador that, as Chevron's Tengiz partner, EM would support Chevron's apparent decision to seek an OFAC ruling on the issue. However, EM believed that an earlier OFAC ruling appeared to cover the current situation. Chevron is "overreacting," Willis concluded, likely out of concern that Chevron Tengiz secondees could be held personally liable if OFAC subsequently objected to the transaction. End note.)

ExxonMobil Seeking New Concessions

¶15. (C) Willis informed Ambassador that EM was attempting to secure additional acreage, both offshore and onshore. He explained that, for the time being, EM was only attempting to secure "access" and conduct technical and seismic studies. The company would then wait for better commercial terms

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before signing exploration contracts. Others were following the same strategy, he said. "Nobody is drilling wells." Willis added that he didn't think the GOK wanted to encourage more exploration either, because Kazakhstan faced too many constraints -- a shortage of skilled labor above all -- to expand its oil operations.

CP Advocacy: Losing to a Petrochemical Promise?

¶16. (C) CP's Janah thanked Ambassador for Secretary Bodman's advocacy for CP's "N Block" bid. "We've done everything we could possibly do on the political front," he concluded. Janah told Ambassador that KMG was scheduled to resume negotiations with Shell that afternoon. He added that he increasingly believed that Shell had promised to build a petrochemical facility in return for the N Block concession. If that is true, he said, then Shell would likely win the bid. "We couldn't afford such a non-economic project," he concluded. However, even if CP lost the N Block bid, USG advocacy had served the company well by "raising its profile" in the eyes of top GOK decision-makers.

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